International
Credit Analysis

Macedonia

Ratings

	Current Ratings
Foreign Currency	
Long-Term IDR	BB+
Short-Term IDR	B
Local Currency	
Long-Term IDR	BB+
Country Ceiling	BBB-

Outlooks

Sovereign Foreign Long-Term IDR	Stable
Sovereign Local Long-Term IDR	Stable

Financial Data

Macedonia

(USDbn)	2007
GDP	7.9
GDP per head (USD, thousands)	3.9
Population (m)	2
International reserves	2.2
Net external debt (% GDP)	-0.4
Central government total debt (% GDP)	24
CG foreign currency debt	1.8
CG domestically issued debt (MKDbn)	33.7

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Related Research

- *Emerging Europe Rating Dynamics (November 2008)*
- *Rating Review of Emerging Markets (November 2008)*
- *Fitch Changes Macedonia's Outlook to Stable*
- *Emerging Europe Sovereign Review: 2008 (August)*
- *Republic of Macedonia, 2007 Credit analysis*

Rating Rationale

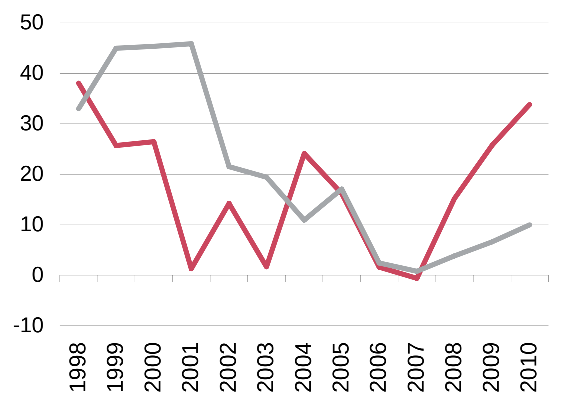
- Macedonia's GDP per capita is USD3,762, a little above the 'BB' median, supporting a rating in the 'BB' range. When allowance is made for differences in purchasing power, the gap in Macedonia's favour is wider. The UN's Human Development Index is also high, equal to the 'BBB' median.
- The business climate as measured by the Ease of Doing Business indicator is also in line with the average score for its rating group. There are many factors which restrain trade and growth, including bureaucratic hindrances, a weak judicial system, inadequate records of property rights, non-competitive markets and inflexible labour markets.
- GDP has grown relatively slowly for its 'BB' peer group (median 6.1% pa), at a five-year average of slightly above 4% pa. The recent trend, however, has been upwards, and this could reassert itself after the current recession.
- Macedonia's large and widening current account deficit is a rating weakness. Since 2006, when it was briefly in line with the 'BB' median, it has deteriorated sharply from virtual balance to a predicted 14% of GDP deficit this year. Fitch Ratings foresees little improvement over the next few years. Underlying this deficit is a massive structural merchandise trade deficit, equivalent to 20% of GDP. This is especially sensitive to rising energy and world metal prices.
- A further rating weakness is the very low rate of gross domestic savings, about 3% of GDP. Gross national savings, however, are buoyed by remittances of some 17% of GDP from Macedonians working abroad. These transfers also help finance the trade deficit. Another source of deficit financing could be FDI, but the country has not attracted much FDI, except as part of its privatisation drive.
- The country's net external debt ratio is in line with the 'BB' peer group median, but Fitch expects it to rise owing to the current account deficit. Its external liquidity ratio bears up to 'BB' median.
- Macedonia's moderate and declining government debt/GDP ratio of 25% is a rating strength. Fiscal policy has been a credit strength, though the recent weakening in the budget balance will add to pressures on the current account.
- Political risk constrains the rating. This includes a long-standing and still unresolved dispute with Greece over the name of Macedonia, which led earlier this year to a Greek veto on Macedonian membership of NATO and has prejudiced the formal negotiations on EU entry. Both NATO and the EU are seen as critical to the country's efforts to quell ethnic rivalries with its substantial Albanian minority. The poor handling of this year's national elections also put a question mark on democratic standards.

Key Rating Drivers

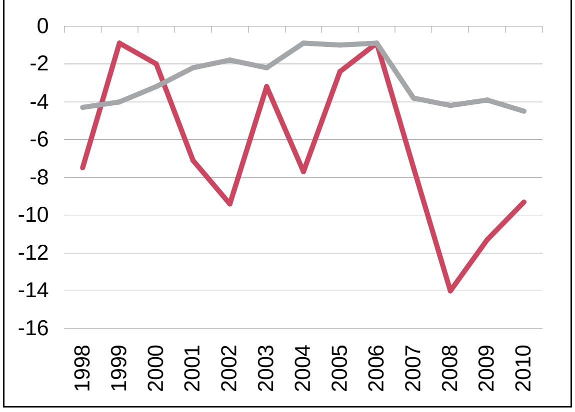
- A failure to reduce the current account deficit could lead to downward rating pressure. In addition, a sharp slowdown in capital inflows that forced an abrupt macroeconomic adjustment, material loss of foreign-exchange reserves or risk to the exchange rate regime would be likely to lead to negative rating action.
- Rising living standards, structural reforms and diversification of the narrow economic base could put upward pressure on the ratings.

Peer Comparison

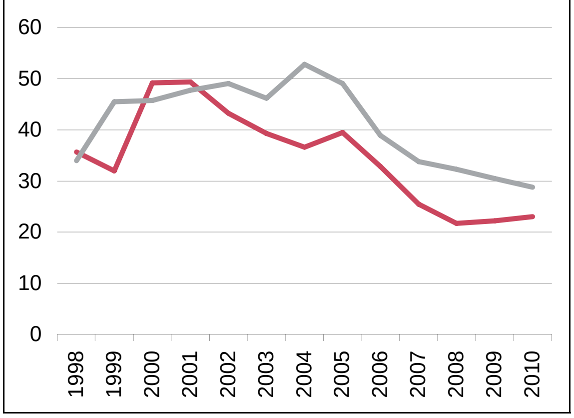
Net External Debt
% of CXR



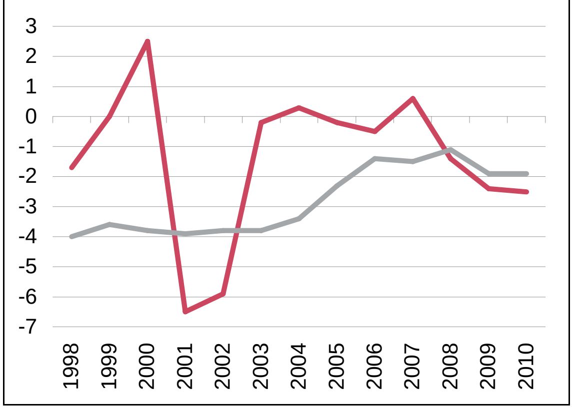
Current Account Balance
% of GDP



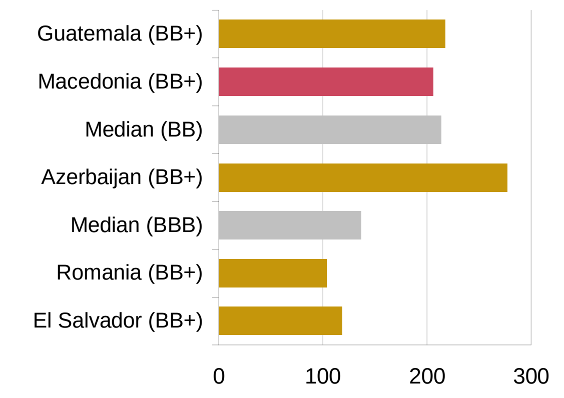
General Government Debt
% of GDP



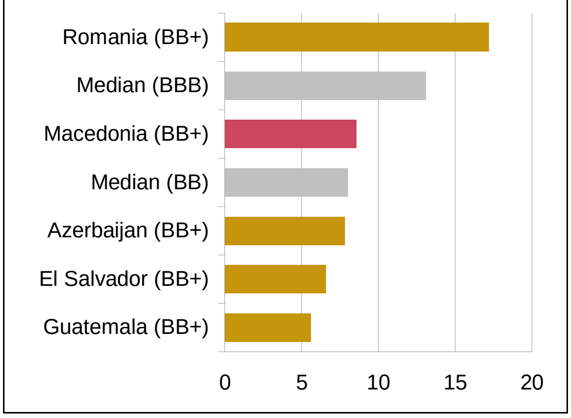
Central Government Balance
% of GDP



International Liquidity Ratio, 2008
%



GDP per capita Income, 2007e
At market exchange rates, USA=100



Macedonia
Medians

Rating Factors

Summary: Strengths and Weakness

Rating Factor	Macroeconomic	Public Finances	External Finances	Structural Issues
Status	Neutral	Strength	Strength	Neutral
Trend	Negative	Negative	Negative	Stable

Note: relative to 'BB' category

Peer Group

Rating	Country
BBB-	Brazil
	Bulgaria
	Croatia
	Iceland
	India
	Kazakhstan
	Latvia
	Morocco, Kingdom of
	Namibia
	Peru
BB+	**Macedonia**
	Azerbaijan
	Colombia
	Egypt
	El Salvador
	Guatemala
	Panama
	Romania
BB	Armenia
	Costa Rica
	Indonesia
	Philippines

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
13 Jun 2008	**BB+**	**BB+**
1 Nov 2005	**BB**	**BB**

Strengths

- GDP has grown consistently but relatively slowly for its 'BB' peer group (median 6.1% pa) at a five-year average of 4% pa, but the trend has been upwards.
- GDP per capita is just above the overall 'BB' median. Macedonia's relative income is even higher if measured in terms of purchasing power parity.
- The country's external liquidity ratio bears up to 'BB' median and it has outperformed its 'BB' peer group median for net external debt for a decade and became a mild net external creditor in 2006. This status is now at risk.
- Remittances have accounted for about 15% or more of GDP, making a powerful contribution to overseas earnings and compensating for the very low 3% of GDP gross rate of domestic savings. The recent trend has been downward.
- Fiscal policy has been a rating strength but the widening of the fiscal deficit since a small surplus was last achieved in 2004 and the planned further deterioration amount to another negative trend, which will inevitably increase public debt. The moderate government debt ratio is an important rating strength.

Weaknesses

- In just two years the balance-of-payments current account, which was briefly in line with the 'BB' median, has deteriorated from virtual balance in 2006 to a predicted 14% deficit this year. Underlying this is a massive trade deficit.
- Net FDI has been running at 2%-9% a year, but primarily at only 3%-5% a year, mainly representing foreign involvement in privatisation rather than greenfield investment, although 2007 was an exception (some USD700m was received).
- For Europe, there is a poor business climate, reflecting inadequate competition, a weak judiciary, bureaucratic corruption and inadequate property rights.
- The political system has failed to secure a settlement of the long-standing dispute with Greece and thus enable Macedonia to obtain the benefits of NATO membership and acceptance as a potential EU member, especially with respect to its substantial Albanian minority. Nor has it yet secured an acceptable democratic electoral system. This year's parliamentary elections were marred by violence.

Local Currency Rating

The Local Currency and Foreign Currency Ratings are the same. This reflects the fact that an exchange rate shock would have a strong impact on the domestic economy, as well as external credit factors, because of Macedonia's high level of euroisation. Local capital markets are also underdeveloped.

Country Ceiling

EU accession aspirations and the large remittances sent home by Macedonians working abroad are an incentive for the government to maintain liberalised transfer and convertibility arrangements and thus justify the 'BBB−' ceiling.

Outlook and Key Issues

Macedonia's outlook is dominated, as with other countries, by the major recession, which is tightening its hold on the international economy. This will have a negative effect on economic growth everywhere, although the exact impact will differ from country to country. Fitch is forecasting a growth rate of about 4% for both 2009 and 2010, in contrast to the government's own forecasts which, continuing the recent upward trend, are for 5.5%-6%. Imports will probably fall faster than exports, which will impart some upward bias to GDP growth, and consumption, both personal and public, and real investment will continue to grow, albeit at a slower rate than this year. As the recession ends, the recent upward trend could reassert itself.

Public Finances: Sources and Uses (% GDP)

	2007	2008f	2009f	2010f
Uses	6.9	4.3	5.5	5.6
Budget balance	0.6	-1.4	-2.4	-2.5
Amortisation (by place of issue)	5.8	2.9	3.1	3.1
Domestic	2.9	2.4	2.3	2.4
Foreign	2.9	0.5	0.8	0.7
Sources	6.9	4.3	5.5	5.68
Gross borrowing (by place of issue)	3.1	3.2	3.1	4.2
Domestic	1.3	1.5	1.5	1.5
Foreign	1.8	1.7	1.6	2.7
Privatisation	0.9	0.0	0.2	0.2
Other	2.9	1.1	2.2	1.2

Source: Fitch Ratings

An easing of the budget balance in 2008 to 2010 will add to domestic demand and also act to restrain the fall in the growth rate. Lower amortisation following the buybacks of debt in recent years will probably limit the impact of a larger deficit on government borrowing until 2010, although the debt/GDP ratio will have begun to rise again, having reached its lowest "post-transition" point in the current year. Although the government wishes to increase the proportion of debt it raises domestically, Fitch has assumed that in the present circumstances gross domestic borrowing will grow no faster than in 2008. The forecast of a sharp jump in foreign borrowing by end-2010 depends on commercial investors' continued willingness to lend to emerging-market governments by that time, as Macedonia has reached the stage where concessional lenders have other urgent calls on their resources. Below the line, privatisation funds will make only a limited contribution. Consequently the government may have to rein in its planned expenditure or else finance it by printing money.

External Finances: Sources and Uses

(USDm)	2007	2008f	2009f	2010f
Uses	**1,007**	**1,580**	**1,330**	**1,220**
Current account deficit	597	1,360	1,080	970
MLT amortisation	410	220	250	250
Sovereign	392	70	100	100
Non-sovereign	18	150	150	150
Sources	**1,007**	**1,580**	**1,330**	**1,220**
Gross MLT borrowing	130	625	670	750
Sovereign	-150	175	120	100
Non-sovereign	280	450	550	650
Net FDI	700	500	500	500
Net portfolio debt	-104	0	0	0
Net portfolio equity	155	150	100	100
Other credit flows nes	-116	285	-25	-250
Net E&O	0	0	0	0
Change in fx reserves	242	20	85	120

Source: Fitch

The size of the jump in the current account deficit in 2007 has just been revised sharply upwards and the current account will be the major strain on external financial resources for the next few years. Overall amortisation will be contained. The demand for external finance will be met largely by borrowing and perhaps some reduction in international reserves, although Fitch has not assumed this. The agency has assumed an unchanging rate of FDI at USD500m a year, which is below the exceptional 2007 figure but in line with the government's aspirations. It is putting much effort into attracting foreign investors, but Fitch's assumptions may well prove optimistic. (In 2007 the figures were boosted by foreign purchases of shares in Macedonian banks.) Overall, the gross financing requirement in 2008 and 2009 will be almost double that in 2007.

Despite a sharp growth in private credit extension, the banking sector remains moderate in size and well capitalised. The average capital adequacy ratio was a system-wide 17% at the end of 2007, down from 21.3% in 2005, but this fall reflected the strong credit growth rather than any inroads into capital through write-offs. The commonly used measure of credit risk fell further in both 2007 and into 2008 and non-performing loans as a percentage of all loans fell consistently from 22% in 2003 to 9% in 2007. Liquidity risk is said to be well controlled. The loan/deposit ratio is less than 100%, a strength in the current global financial environment.

Fiscal policy has been sound. The fiscal deficit has been kept low and last year there was a surplus, admittedly an unexpected one. Public debt has fallen sharply over the past two years from almost 40% of GDP to about 25%. These figures are far superior to the 10-year medians for both the 'BB' and 'BBB' rating peer groups. However, the government has now relaxed the budget constraints and Fitch's latest forecast deficit for 2008 is 1.5% of GDP, which is also the official target. Fitch believes that the deficit could reach 2.5% or more in 2009 and 2010, well above targets, as expenditure, which is expected to have jumped smartly this year, is maintained at relatively high levels while revenue, which has risen in response to

Forecast Summary

	2004	2005	2006	2007	2008[f]	2009[f]	2010[f]
Macroeconomic Indicators and Policy							
Real GDP growth (%)	4.1	4.1	4.0	5.9	5.5	3.0	3.0
Consumer prices (annual average % change)	-0.4	0.5	3.2	2.3	8.0	4.0	3.0
Short-term interest rate (%)[a]	8.3	9.7	6.1	5.1	7.0	5.0	4.0
Central government balance (% of GDP)	0.0	0.2	-0.5	0.6	-1.4	-2.4	-2.5
Central government debt (% of GDP)	35.9	38.7	32.1	24.0	20.6	23.4	27.1
MKD per USD (annual average)	49.4	49.3	48.8	44.7	41.9	46.2	46.2
Real effective exchange rate (2000=100)	100.7	99.6	100.0	100.4	105.4	105.4	105.4
External Finance							
Current account balance (USDbn)	-0.4	-0.1	-0.1	-0.6	-1.4	-1.1	-1.0
Current account balance (% of GDP)	-7.7	-2.4	-0.9	-7.5	-14.0	-11.3	-9.3
Current account balance plus net FDI (% of GDP)	-4.8	-0.7	4.6	1.3	-8.9	-6.1	-4.5
Net external debt (USDbn)	0.7	0.6	0.1	0.0	1.0	1.9	2.7
Net external debt (% of GDP)	13.5	10.2	1.1	-0.4	10.5	19.8	26.3
Net external debt (% of CXR)	24.1	16.2	1.6	-0.6	15.2	25.8	33.8
Official international reserves including gold (USDbn)	1.0	1.3	1.9	2.2	2.3	2.4	2.5
Official international reserves in months of CXP cover	3.5	4.2	5.1	4.3	3.4	3.4	3.3
External interest service (% of CXR)	1.6	1.6	2.0	1.6	1.3	1.3	1.2
Gross external financing requirement (% int. reserves)	66.1	32.3	40.3	53.5	70.6	57.7	51.6
Memo: Global Forecast Summary							
Real GDP growth (%)							
US	3.6	2.9	2.8	2.0	1.4	-1.2	1.2
Japan	2.7	1.9	2.5	2.1	0.5	0.5	1.7
Euro area	3.6	2.9	2.8	2.0	1.4	-1.2	1.2
World	-	-	-	-	-	-	-
Commodities							
Oil, USD/barrel	-	-	-	-	-	-	-

[a] 28 day Central Bank bill irate (annual average).
Source: Fitch

substantial tax reforms, is allowed to fall back more decisively as social contributions are progressively reduced (from the present 32% to 22%)

Tax reform has contributed to the relative success of fiscal policy. The introduction of a "flat rate" personal income tax in January 2007, when the existing rate structure (15%, 18% and 24%) was swept aside in favour of a single rate of 12%, subsequently reduced to 10% in January 2008, had several favourable effects, particularly when allied to the contemporaneous reduction in profits tax from 15% to initially 12% and subsequently 10%. (There were also changes in rates and coverage of VAT and excise taxes.) The tax on the labour wedge was much reduced, thus encouraging employment, and personal consumption, one of the main drivers of economic growth, was also encouraged. Perhaps of more significance is that the growth led to an unexpectedly strong increase in actual revenues in 2007 despite the cuts in tax rates. The government hopes this performance will be repeated in 2008. Revenue growth was certainly strong in H108 (a surplus of 1.2% of GDP) and sufficiently so for the government to continue the tradition of supplementary budgets. This one, like those in 2007, is meant to increase expenditure sufficiently to leave the budgeted deficit unchanged. Critics have argued that in view of the exceptional GDP growth, the expected usual burst of growth in the fourth quarter and the looming threat of recession abroad, it would have been better at this stage to take the revenue savings and avoid discretionary expenditure.

As noted above, public debt is low, well below that of its rating peers. Broadly, it has fallen consistently from 57% of GDP in 2000 to current levels. This has involved some early repayment financed by privatisation funds and government deposits. Fitch expects some increase in debt ratios in the next few years but insufficient to alter its fundamental view that debt levels are acceptable, not much more than half the government's self-imposed limit of 40% of GDP and well below the 60% Maastricht limit. Other factors contribute to this view. Debt maturities are close to the 'BB' median. The share of domestic debt, inhibited in the past by the slow development of domestic capital markets, is slowly rising, thus reducing foreign-exchange risk. However, about two-fifths of domestic debt is denominated in foreign currency, so the current foreign-currency/domestic-currency split is heavily in favour of the former. The reduction of the FX proportion is a high priority for the government, but possibly difficult to obtain in the prospective circumstances. The interest rate structure is approximately balanced, half at fixed rate and half at variable rates.

The analysis in this report is conducted in terms of central government finances rather than consolidated general government finances, which is Fitch's normal practice, as the authorities have been unable to provide reliable statistics for the latter. This is a rating weakness. The central government statistics that have been provided combine "core" government activities with those of four budgetary funds (pensions, employment, health and roads), three of which are jointly referred to as "social security funds". The main omission is local government, which was only established in June 2005. It is estimated that total local government expenditure in 2008 will be about 5% of GDP with a balanced budget. The central government is believed to account for almost all general government debt, with or without consolidation.

Arrears in the healthcare sector, municipal authorities and subsidies for the energy sector (estimated by the IMF at 2% of GDP in 2007) are potential sources of negative fiscal surprises and the government's successful tackling of these issues as part of its broader structural reform programme would be an important anchor for longer-term confidence in public finances.

Macedonia has suffered a number of political setbacks in the past year. At the instigation of Greece, which objects to the use of Macedonia as the country's name, NATO refused to accept Macedonia's application for membership. This would have done much to stabilise the country's international position. Many also believe that

Greek opposition was one of the factors which caused the EU Commission to refuse to support the EU setting a date for accession negotiations to begin with Macedonia. This would have brought both political and economic benefits. In particular, it would have helped to reconcile the large Albanian minority to their continued Macedonian citizenship.

Politically, the dispute with Greece is unlikely to be resolved soon, as it will require Macedonia to give way to the Greek demands more or less completely, which Fitch does not believe is politically feasible for the current government, relying as it does on nationalists for electoral support. The Greeks have maintained their position for close on two decades and, rightly or wrongly, have no reason to compromise. The Macedonian government presumably agrees with this analysis, as in mid-November 2008 it launched a case against Greece in the International Court of Justice. Lengthy proceedings are expected, with no early resolution.

The EU's formal report on the country's readiness for membership was published in early November. Although it acknowledged that Macedonia had made some progress, the EU was critical of the way in which the spring 2008 parliamentary elections had been organised, the poor state of relations between the political parties and the general level of corruption. There was also considerable nervousness surrounding the establishment of Kosovo's independence and its implications for the ambitions of Macedonia's own Albanian minority. These fears seem to have proved unfounded, but the handling of national elections this year (effectively a major EU benchmark for Macedonia) was poor, some say disastrous. There was sporadic violence and open corruption and ballot box stuffing in some areas, which forced second and subsequent elections to be held in a number of constituencies. The elections were won comfortably by the existing centre-right led coalition. Local and presidential elections to be held next spring will be closely watched to see if the malign influence of local groups/parties in the worst-affected areas has been curbed.

Comparative Analysis: Macroeconomic Performance and Policies

Macedonia

	2007						
	Azerbaijan 'BB+'	El Salvador 'BB+'	Guatemala 'BB+'	Macedonia 'BB+'	Romania 'BB+'	'BB' median	'BBB' median
Real GDP (5yr average % change)	19.8	3.2	4.0	4.2	6.4	6.2	5.4
Volatility of GDP (10yr rolling SD)	8.6	1.0	1.2	2.9	4.1	3.5	2.1
Consumer prices (5yr average)	8.1	4.0	6.8	1.4	9.5	7.3	5.0
Volatility of CPI (10yr rolling SD)	5.7	1.4	1.1	2.3	19.4	3.5	2.2
Years since double-digit inflation	0.0	12.0	11.0	12.0	3.0	n.a.	n.a.
Unemployment rate	1.4	7.0	3.0	34.6	4.1	7.5	7.2
Type of exchange rate regime				Pegged (EUR)		n.a.	n.a.
Dollarisation ratio	47.0	100.0	13.8	51.5	51.0	38.4	24.0
REER volatility (10yr rolling SD)	9.4	1.7	4.6	2.8	12.0	9.2	6.1

Source: Fitch

Strengths

- Average GDP growth over the five years since the economy recovered from the international downturn in 2001 has been relatively slow compared to the 'BB' median and all but one of Macedonia's 'BB+' peers. The trend, however, has been rising over the past two years and will be up again this year at 5.5% (or even 6%) growth, when it will be more in line with the 'BB' median (6.1%) and will be the highest rate Macedonia has achieved in the transition period. Growth in the coming year or so is bound to be weaker as the international recession bites, but strong investment and a plentiful labour supply could provide more substantial growth in the medium term. The volatility of GDP growth is acceptably midway between the 'BB' and 'BBB' medians.
- The fixed exchange rate regime (the denar is pegged to the euro) has helped to anchor price expectations and may well do so again. It is, however, a considerable constraint on policy, in contrast to more flexible regimes in which maintaining the external value of the currency is not an over-riding concern to the exclusion of other economic objectives such as growth and employment.

Weaknesses

- Following the end of the hyper inflation associated with the break-up of Yugoslavia, consumer price inflation looked well under control up to 2007, when it spiked sharply under the influence of the major 2008 commodity price boom, reaching 10% or so during the summer. It is now moderating as international energy and food prices subside. Although the 10-year volatility measure of the Macedonian CPI is low, domestic prices are especially sensitive to food and energy prices. Food prices make up almost two-fifths of the official CPI basket. The outlook is for a relatively swift return to previous low levels as the international recession intensifies and the exchange rate anchor plays its part, but the risk is that an eventual recovery will reignite commodity price inflation.
- Government efforts to smother domestic price rises by the use of subsidies, especially on energy, have both adverse fiscal and allocative results.
- Unemployment is among the world's highest at about 35%, although there has been some marginal decrease in recent years. The countervailing benefit is a ready supply of labour, although there are conflicting views as to its quality.
- Dollarisation, more accurately euroisation, is high, a legacy of the communist era in which banks were distrusted and the strong presence of foreign banks.

Commentary

Macroeconomic performance is rating neutral but the recent trend is disappointing.

Comparative Analysis: Structural Features

Macedonia

	2007						
	Azerbaijan 'BB+'	El Salvador 'BB+'	Guatemala 'BB+'	Macedonia 'BB+'	Romania 'BB+'	'BB' median	'BBB' median
GNI per capita PPP (USD, latest)	6,260	5,590	4,440	8,500	10,980	6,450	9,630
GDP per capita (USD, mkt exchange rates)	3,521	2,971	2,514	3,880	7,744	3,621	6,761
Human Development Index (percentile, latest)	44.7	41.9	0.7	61.8	66.8	48.9	60.5
Ease of Doing Business (percentile, latest)	45.8	59.9	115.0	46.4	69.5	47.0	69.6
Trade openness	66.8	50.1	44.9	74.6	45.5	n.a.	n.a.
Gross domestic savings (% GDP)	55.5	-5.1	3.8	6.4	15.3	20.8	24.1
Gross national savings (% GNP)	61.4	10.9	16.1	15.7	16.2	20.5	26.4
Gross domestic investment (% GDP)	20.1	16.1	20.7	22.5	29.6	23.3	26.1
Private credit (% GDP)	16.3	42.3	35.2	36.8	36.9	32.3	61.6
BSR indicators	E3	D1	n.a.	n.a.	n.a.	n.a.	n.a.
Bank system CAR	19.9	13.8	12.9	17.0	12.7	n.a.	n.a.
Foreign bank ownership (% of assets)	28.5	96.0	11.6	71.3	88.0	n.a.	n.a.
Public bank ownership (% of assets)	42.3	4.0	5.9	8.7	5.0	18.5	20.1
Default record (year cured)	n.a.	n.a.	1989	1997	1984	n.a.	n.a.

Source: Fitch and World Bank

Strengths

- Macedonia's GDP per capita at market exchange rates is just above the overall 'BB' median. When allowance is made for differences in purchasing power, the gap in Macedonia's favour is greater. GNI per capita at PPP is about a third above the 'BB' median, but still substantially below the BBB median.
- Macedonia's ranking on the UN's Human Development Index is also high, equal to the 'BBB' median, which may be put down to the continuing affects of the country's communist background, with its emphasis on education and welfare.
- Macedonia has an average score for its rating group on the Ease of Doing Business indicator, although it had improved rapidly in previous years. It rates highly on trade openness since its adoption of the EU's open trade policies.
- Despite a sharp growth in private credit extension, the banking sector remains moderate in size and well capitalised.

The government has launched a major programme of reform designed to boost trade and growth rates by reducing bureaucratic hindrances, improving judicial performance, securing adequate records of property rights, promoting competitive markets and encouraging labour market and fiscal reform.

Weaknesses

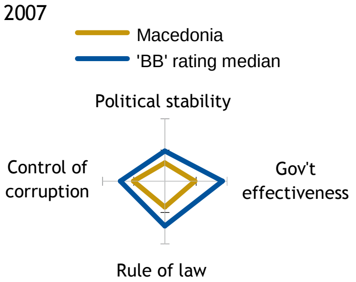
- A major economic weakness is the low (around 3% of GDP) rate of gross domestic saving. It has been bolstered, however, for a number of years by remittances sent home by Macedonians working abroad. This takes gross national savings to 20% of GDP, only marginally below the 'BB' median and partially enabled the country, at least in the latest period, to sustain domestic investment close to the median for 'BB' countries.
- Private credit at 38% of GDP is not a particular weakness — it is a little above the 'BB' median, although well below the 'BBB' median. The weakness has been the rate of growth, which has doubled the ratio since 2004 and seen annual increases of almost 40%. This has been a powerful factor in sustaining the consumer and investment booms, which have led in turn to the rapid growth of imports.

Commentary

Structural features are broadly neutral for the present rating.

Governance Indicators

2007



SSource: World Bank, Fitch

Comparative Analysis: External Finances

Macedonia

	2007					Last 10 years	
	Azerbaijan 'BB+'	El Salvador 'BB+'	Guatemala 'BB+'	Macedonia 'BB+'	Romania 'BB+'	'BB' median	'BBB' median
GXD(% CXR)	24.7	97.8	46.6	71.1	119.3	113.8	104.6
GXD(% GDP)	20.3	46.3	19.7	50.4	45.9	44.6	49.6
NXD(% CXR)	-5.6	43.3	9.6	-0.6	37.2	25.0	26.1
NXD(% GDP)	-4.6	20.5	4.1	-0.4	14.3	11.1	12.8
GSXD(% GXD)	41.3	59.9	63.8	33.6	14.3	52.4	36.6
NSXD(% CXR)	-7.5	35.1	-0.4	-16.0	-44.8	17.0	-4.4
NSXD(% GDP)	-6.2	16.6	-0.2	-11.3	-17.3	6.8	-2.1
SNFA (USDbn)	4.3	-3.4	0.1	0.9	n.a.	-2.4	0.3
SNFA(% GDP)	14.5	-16.6	0.2	11.3	n.a.	-6.4	1.2
Ext. debt service ratio(% CXR)	3.6	17.9	8.3	8.9	14.3	16.6	15.7
Ext. interest service ratio(% of CXR)	1.1	8.7	4.8	1.6	2.6	5.5	4.1
Liquidity ratio (latest)	212.7	112.1	241.8	214.4	128.4	117.3	114.8
Current account balance(% GDP)	30.7	-5.5	-5.1	-7.5	-13.9	-2.7	-2.8
CAB plus net FDI(% GDP)	13.6	1.5	-3.1	1.3	-8.2	1.5	0.4
Commodity dependence (% of CXR, latest)	79.8	18.3	32.8	16.6	13.8	30.8	18.8
Sovereign net FX debt(% of GDP)	8.4	27.0	1.3	-2.2	-16.9	n.a.	n.a.

Source: Fitch

Strengths

- Macedonia's gross external debt is not much more than half the median debt of its 'BB' peer group when measured against export earnings (CXR). However, as a share of GDP it is almost identical. Macedonia's advantage is much clearer for net external net: it has been a net external creditor for two years. Both the 'BB' and 'BBB' median positions show moderate net debt.
- Sovereign debt encompasses central government and central bank external borrowing. (It excludes central bank domestic borrowing, as this is mainly carried out for monetary policy purposes.) The sovereign in Macedonia's case is a net external creditor, having established substantial assets in the form of international reserves. NSXD is equivalent to the net foreign assets position, as there are no known government equity assets to be added to the latter. As with the overall position, the sovereign is significantly stronger than its 'BB' and 'BBB' peer groups as measured by their medians, although the latter group are in aggregate (just) net creditors. Although there are no available peer group medians, this strength probably extends to net sovereign FX debt, where again Macedonia is a net creditor. Macedonian banks are also net creditors.
- All the other major external debt indicators reflect this relative strength. The debt and interest service ratios and the liquidity ratio are all substantially stronger than the corresponding peer group medians.

Weaknesses

- The strong net external creditor position will come under pressure from a deteriorating current account. The CAD has grown sharply from close to zero in 2006 to an estimated 12%-13% in 2008. This decline has several causes, including a large swing in the terms of trade associated with the rise in commodity and food prices and a fall in remittances which began in 2007. Imports rose much faster than exports which are over-dependent on oil derivatives, iron and steel and textiles, which have been hit by changes in the international quota system.

Commentary

External finances are generally a rating strength but have recently turned negative.

Comparative Analysis: Public Finances

Macedonia

	2007					Last 10 years	
	Azerbaijan 'BB+'	El Salvador 'BB+'	Guatemala 'BB+'	Macedonia 'BB+'	Romania 'BB+'	'BB' median	'BBB' median
Budget balance(% GDP)	1.4	-1.9	-1.5	-1.0	-2.3	-2.6	-2.6
Primary balance(% GDP)	1.7	0.6	0.0	-0.9	-1.7	0.7	-0.2
Revenues and grants(% of GDP)	32.0	17.9	13.0	35.5	31.4	23.8	31.9
Volatility of revenues/GDP ratio	18.6	6.8	7.2	4.5	3.2	7.2	6.7
Interest payments (% revenue)	0.9	13.9	11.6	2.2	2.2	12.4	7.6
Debt(% revenue)	29.8	215.6	167.9	69.4	62.2	192.5	119.8
Debt(% GDP)	9.6	38.5	21.9	24.6	19.5	45.2	36.2
Net debt(% GDP)	n.a.	38.5	12.7	19.4	15.9	37.7	25.1
FC debt (% of total debt)	87.7	99.1	64.0	100.0	35.3	63.7	46.4
CG debt maturities(% GDP)	n.a.	1.0	1.7	5.6	0.7	5.9	6.6
Average duration of CG debt (years)	n.a.	n.a.	n.a.	2.0	n.a.	1.9	6.5

* GG if not otherwise specified

Source: Fitch

Strengths

- Fiscal policy has been sound. The fiscal deficit has been kept low and last year there was a surplus, admittedly an unexpected one. Public debt has fallen sharply over the past two years from almost 40% of GDP to about 25%. These figures are far superior to the 10-year medians for both the 'BB' and 'BBB' rating peer groups. However, the government has now relaxed the budget constraints and larger deficits are expected.
- Tax reform has contributed to the relative success of fiscal policy. The introduction of a "flat rate" personal income tax in January 2007, when the existing rate structure (15%, 18% and 24%) was swept aside in favour of a single rate of 12%, subsequently reduced to 10% in January 2008, had several favourable effects, particularly when allied to the contemporaneous reduction in profits tax from 15% to initially 12% and subsequently 10%. (There were also changes in rates and coverage of VAT and excise taxes.)
- Public debt is low, well below that of its rating peers. Fitch expects some increase in debt ratios in the next few years, but insufficient to alter its fundamental view that debt levels are acceptable. Debt maturities are close to the 'BB' median. The interest rate structure is approximately balanced, half at fixed rate and half at variable rates. FX debt remains high.

Weaknesses

- The analysis in this report is conducted in terms of central government finances rather than consolidated general government finances, which is Fitch's normal practice, as the authorities have been unable to provide statistics for the latter.
- Arrears in the healthcare sector, municipal authorities and subsidies for the energy sector (estimated by the IMF at 2% of GDP in 2007) are potential sources of negative fiscal surprises and the government's successful tackling of these issues as part of its broader structural reform programme would be an important anchor for longer-term confidence in public finances.

Commentary

Fiscal policy has been a rating strength and public debt has been sharply reduced. The risk is that the government might relax its stance too far during the recession.

Fiscal Accounts Summary

% of GDP	2005	2006	2007	2008f	2009f	2010f
General government						
Revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
o/w interest payments	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Primary balance	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Overall balance	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
General government debt (MOF estimates)	**39,5**	**32,9**	**25,5**	**21,7**	**22,2**	**23,1**
% of General government revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
General government deposits	8.7	12.6	7.0	n.a.	n.a.	n.a.
Net general government debt	28.8	22.0	19.4	n.a.	n.a.	n.a.
Central government						
Revenue	35.2	33.5	33.8	35.7	34.2	33.4
o/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure & net lending	35.0	34.0	33.2	37.1	36.6	35.9
o/w current expenditure & transfers	31.4	31.0	29.3	30.5	30.3	29.1
- interest	0.9	1.0	0.8	0.6	0.6	0.6
o/w capital expenditure	3.6	3.0	3.9	6.7	6.3	6.8
Current balance	3.8	2.4	4.5	5.3	3.9	4.4
Primary balance	1.1	0.5	1.4	-0.8	-1.8	-1.9
Overall balance	0.2	-0.5	0.6	-1.4	-2.4	-2.5
Central government debt	38.7	32.1	24.0	20.6	23.4	27.1
% of central government revenues	109.8	96.0	71.0	57.6	68.3	74.6
Central government debt (MKDbn)	**110.8**	**99.9**	**84.9**	83.4	103.4	130.6
By residency of holder						
Domestic	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0
By place of issue						
Domestic	36.9	39.7	33.7	30.5	37.4	44.6
Foreign	73.9	60.1	51.3	52.8	66.0	86.0
By currency denomination						
Local currency	7.0	12.7	10.6	10.7	21.0	31.7
Foreign currency	103.8	87.2	74.4	72.7	82.5	98.8
in USD equivalent (eop exchange rate)	2.0	1.9	1.8	1.6	1.8	2.1
By maturity						
Less than 12 months (residual maturity)	8.6	20.1	19.8	10.7	16.5	13.2
Average maturity (years)	7.4	6.7	6.9	6.5	n.a.	n.a.
Average duration (years)	1.2	0.9	2.0	1.9	n.a.	n.a.
Memo:						
Non-financial public-sector balance (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net non-financial public-sector debt (% of GDP)	38.2	28.7	26.9	18.1	21.3	27.2
Nominal GDP (MKDbn)	286.6	310.9	353.8	405.0	442.2	481.9

Source: Ministry of Finance and Fitch estimates and forecasts

External Debt and Assets

(USDbn)	2002	2003	2004	2005	2006	2007
Gross external debt	**1.6**	**1.9**	**2.8**	**3.0**	**3.3**	**4.0**
% of GDP	42.8	40.0	52.5	51.1	51.6	50.4
% of CXR	83.1	73.3	93.9	81.2	75.0	71.1
By maturity						
Medium- and long-term	1.6	1.8	2.2	2.3	2.6	2.8
Short-term	0.1	0.0	0.6	0.7	0.7	1.2
% of total debt	3.9	2.3	21.1	22.1	22.1	29.3
By debtor						
Monetary authorities	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.0**
General government	**1.4**	**1.5**	**1.7**	**1.8**	**1.7**	**1.3**
o/w Central government	0.0	0.0	0.0	0.0	0.0	0.0
Banks	**0.1**	**0.1**	**0.2**	**0.2**	**0.4**	**0.6**
Other sectors	**0.2**	**0.2**	**1.0**	**0.9**	**1.2**	**2.1**
Gross external assets (non-equity)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
International reserves, incl. gold	0.8	0.9	1.0	1.3	1.9	2.2
Other sovereign assets nes	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deposit money banks' foreign assets	0.6	0.7	0.8	0.7	0.9	0.9
Other sector foreign assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net external debt	**0.3**	**0.0**	**0.7**	**0.6**	**0.1**	**0.0**
% of GDP	7.3	0.9	13.5	10.2	1.1	-0.4
% of CXR	14.2	1.7	24.1	16.2	1.6	-0.6
Net sovereign external debt	0.5	0.5	0.5	0.3	-0.4	-0.9
% of GDP	12.2	9.7	9.7	5.3	-5.7	-11.3
Net bank external debt	-0.5	-0.6	-0.7	-0.5	-0.5	-0.4
Net other external debt	0.2	0.2	0.6	0.6	0.8	1.4
Net international investment position	n.a.	**-2.0**	**-2.5**	**-2.3**	**-2.5**	n.a.
% of GDP	n.a.	-43.2	-46.5	-40.1	-38.8	n.a.
Sovereign net foreign assets	**-0.4**	**-0.4**	**-0.5**	**-0.2**	**0.4**	**0.9**
% of GDP	-11.0	-9.0	-8.5	-4.0	5.7	11.3
Debt service (principal & interest)	**0.2**	**0.3**	**0.2**	**0.2**	**0.6**	**0.5**
Debt service (% of CXR)	12.1	10.0	8.3	6.4	12.8	8.9
Interest (% of CXR)	2.7	2.1	1.6	1.6	2.0	1.6
Liquidity ratio (%)	428.6	378.2	471.8	203.9	161.6	214.4
Net sovereign FX debt (% of GDP)	30.1	26.7	24.4	16.4	4.9	-2.2
Memo						
Nominal GDP	3.8	4.6	5.4	5.8	6.4	7.9
Gross sovereign external debt						
Inter-company loans	0.0	0.0	0.4	0.3	0.4	0.6

Debt Service Schedule on Medium- and Long-Term Debt at 31 Oct 2008

(EURm)	2007	2008	2009	2010	2011	2012	2013+
Sovereign	**233.2**	**28.1**	**33.7**	**38.0**	**43.8**	**49.2**	**62.2**
Official bilateral	88.9	2.5	2.5	4.4	6.4	6.5	6.6
o/w Paris Club	86.5	0	0	0	0	0	0
Multilateral	143.4	25.5	31.1	33.6	37.4	42.7	55.6
o/w IMF	41.7	0	0	0	0	0	0
Other	0.9	0.1	0.2	0	0	0	0
Bonds placed in foreign markets	0	0	0	0	0	0	0
Non-resident holdings of domestic debt	0	0	0	0	0	0	0
Interest	28.4	25.3	27.2	35.7	46.3	61.0	60.6
Total sovereign debt service	**261.6**	**53.4**	**60.9**	**73.7**	**90.1**	**110.2**	**122.7**
Private sector (USDm)	**n.a.**	**n.a.**	**236.3**	**228.3**	**244.0**	**241.0**	**542.6**
Amortisation	n.a.	n.a.	181.9	170.8	190.6	183.8	394.6
Interest	n.a.	n.a.	54.4	57.5	53.4	57.2	148.1
Total private debt service (EURm)	**n.a.**	**n.a.**	**177.9**	**171.9**	**183.7**	**181.5**	**408.6**
Memo (EURm)							
Non-sovereign public sector	**11.7**	**15.1**	**17.3**	**19.9**	**24.1**	**42.5**	**71.1**

Sources: Ministry of Finance, Central Bank and Fitch

Balance of Payments

(USDbn)	2005	2006	2007	2008f	2009f	2010f
Current account balance	**-0.1**	**-0.1**	**-0.6**	**-1.4**	**-1.1**	**-1.0**
% of GDP	-2.4	-0.9	-7.5	-14.0	-11.3	-9.3
% of CXR	-3.8	-1.3	-10.6	-20.3	-14.8	-12.0
Trade balance	**-1.1**	**-1.3**	**-1.6**	**-2.9**	**-2.8**	**-3.0**
Exports, fob	2.0	2.4	3.3	3.9	4.4	4.9
Imports, fob	3.1	3.7	5.0	6.8	7.2	7.9
Services, net	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**0.1**
Services, credit	0.5	0.6	0.8	0.8	0.9	0.9
Services, debit	0.5	0.6	0.7	0.8	0.8	0.9
Income, net	**-0.1**	**0.0**	**-0.4**	**-0.3**	**-0.3**	**-0.2**
Income, credit	0.0	0.1	0.1	0.2	0.1	0.1
Income, debit	0.2	0.1	0.5	0.5	0.4	0.3
O/w: interest payments	0.1	0.1	0.1	0.1	0.1	0.1
Current transfers, net	**1.1**	**1.2**	**1.4**	**1.8**	**2.0**	**2.2**
Memo:						
Non-debt-creating inflows (net)	0.1	0.4	0.9	0.7	0.6	0.6
o/w equity FDI	0.1	0.4	0.7	0.5	0.5	0.5
o/w portfolio equity	0.1	0.1	0.2	0.2	0.1	0.1
o/w other	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves (-=increase)	0.4	0.4	0.2	0.0	0.1	0.1
Gross external financing requirement	0.3	0.5	1.0	1.6	1.3	1.2
Stock of international reserves, incl. gold	1.3	1.9	2.2	2.3	2.4	2.5

Sources: IMF and Fitch estimates and forecasts